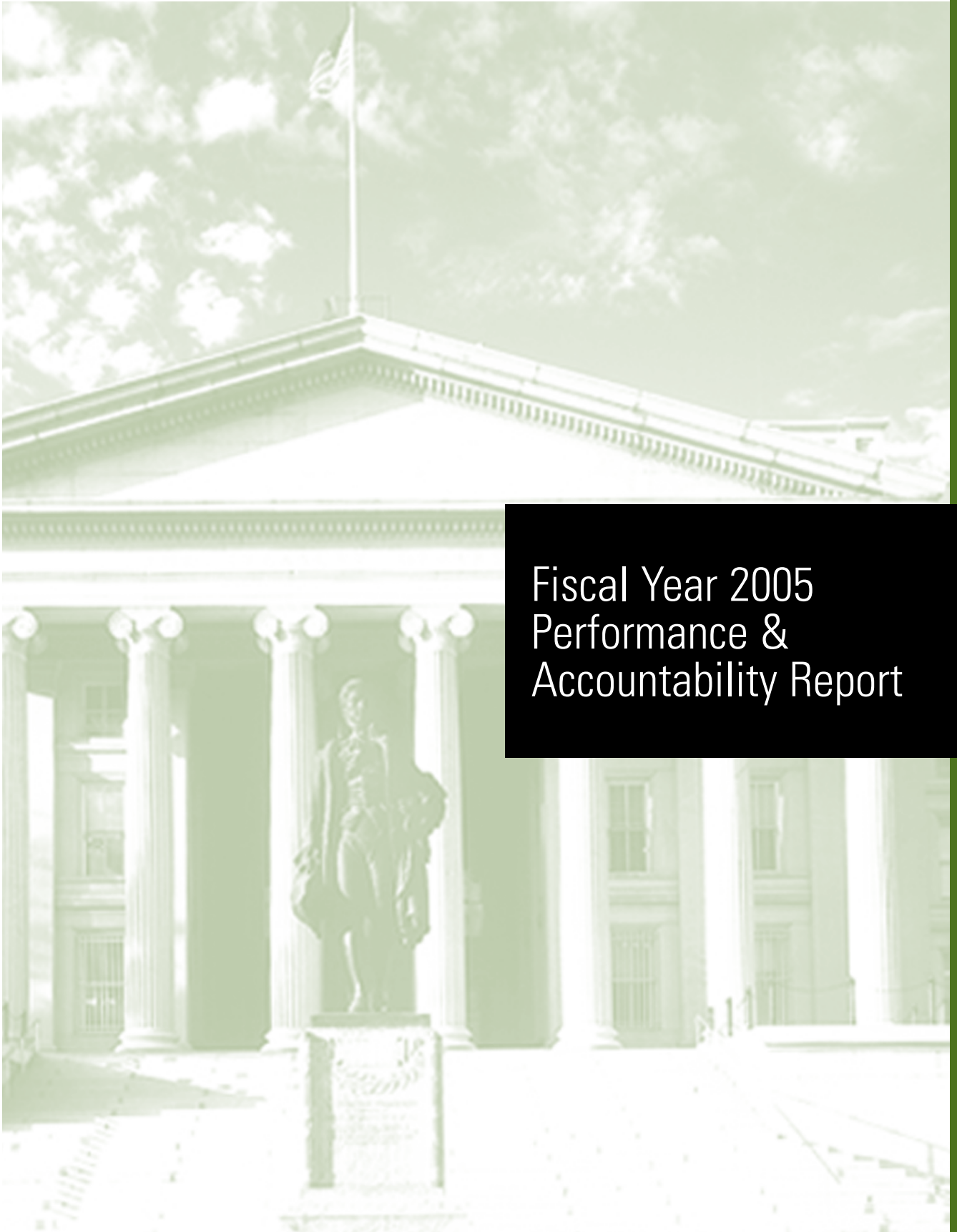


Department of the Treasury



Fiscal Year 2005
Performance &
Accountability Report

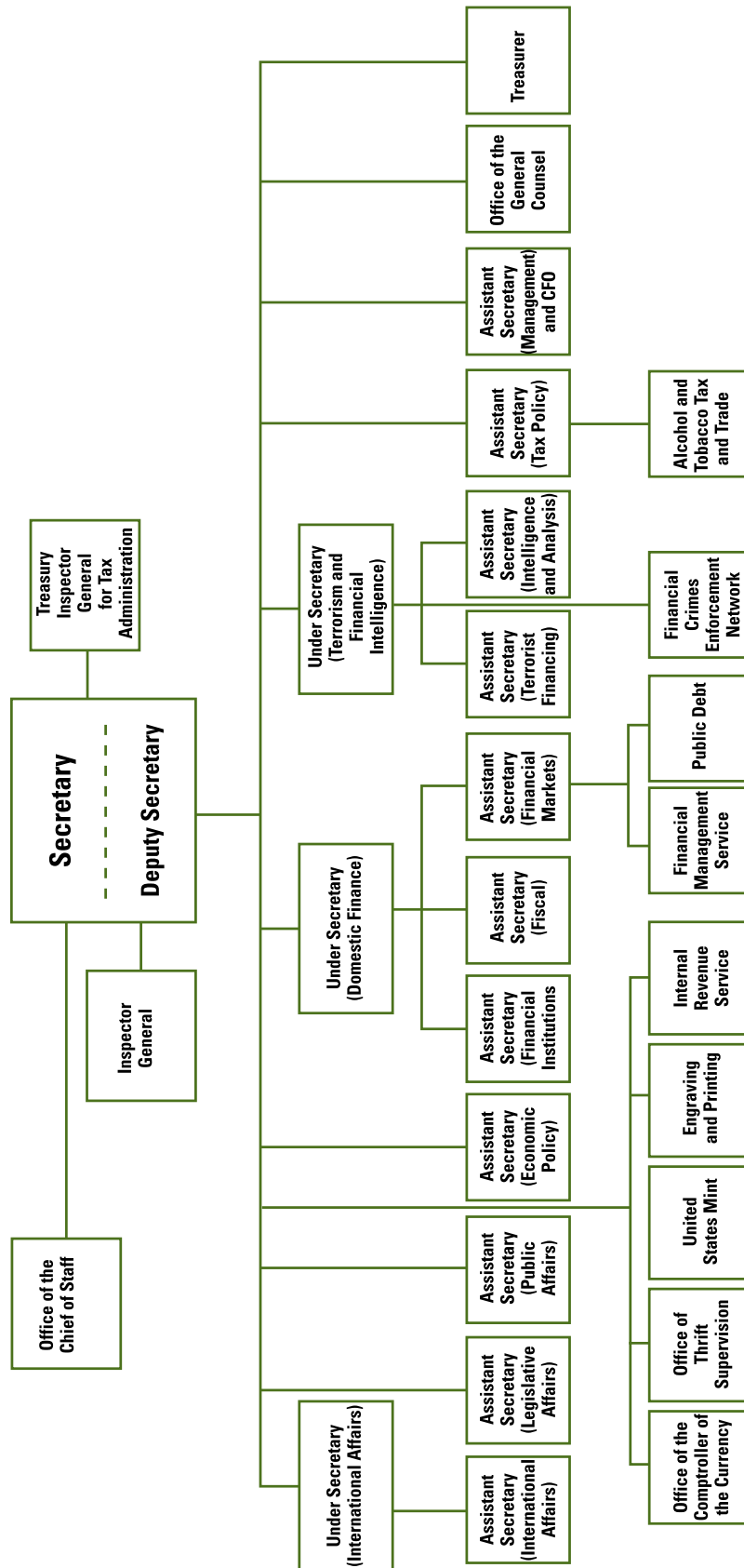
Mission: The mission of the Department of the Treasury is to promote the conditions for prosperity and stability in the United States and encourage prosperity and stability in the rest of the world.

History: On September 2, 1789, the First Congress of the United States created a permanent institution for the management of government finances. The Congress assembled a Department of the Treasury and named the following officers: a Secretary of the Treasury, a Comptroller, an Auditor, a Treasurer, a Register, and an Assistant to the Secretary.

Alexander Hamilton took the oath of office as the first Secretary of the Treasury on September 11, 1789. Hamilton foresaw the development of industry and trade in the United States, and suggested that government revenues be based upon customs duties. His vision also inspired investment in the Bank of the United States, which acted as the government's fiscal agent. Throughout history, the Department of the Treasury has been a dynamic institution of the government's service to the people, expanding to accommodate a growing and ever-changing nation.

Leadership Changes: Treasury experienced leadership changes in Fiscal Year (FY) 2005 with the departure of Deputy Secretary Samuel Bodman (now Secretary of Energy), and a handful of other top officials. During the third quarter of 2005, the Administration nominated and the Senate confirmed a new Treasury deputy secretary, two under secretaries, and five assistant secretaries including a newly created position, the assistant secretary for the Office of Intelligence and Analysis, as well as new leadership at the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the Alcohol and Tobacco Tax and Trade Bureau.

DEPARTMENT OF THE TREASURY



What's New about This Report?

This year Treasury made an effort to revise the Performance and Accountability Report (PAR) based on comments from our stakeholders. The revised report improves accessibility, readability and transparency over last year. Below are some of the key changes made this year.

Greater Accessibility

- Treasury provides a direct link from the Treasury internet home page to the FY 2005 Performance and Accountability Report

Improved Readability

- Reduced the size of the report by approximately 120 pages, a 30% reduction, while improving content
- Created a summary PAR document—an overview of important points from the full version

More Transparent

- Streamlined the number of official performance measures from 299 in the FY 2004 PAR to 126 in the FY 2005 PAR; a 58% reduction
- Provided details about each of Treasury's programs evaluated using the Program Assessment Rating Tool
- Included an expanded narrative on the IRS
- Enhanced the section on Treasury's future plans to improve performance for each official performance measure

Focused on Treasury's Impact to the American People

- Included highlights of Treasury's operations
- Included pictures and vignettes of important events

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About this Report

Purpose

The Department of the Treasury's Performance and Accountability Report (PAR) for FY 2005 provides information that enables Congress, the President and the public to assess the Department's performance relative to its mission and stewardship of the resources entrusted to it. Treasury's report is designed around three areas of focus: Creating the Conditions for Prosperity (Economic), Financing the U.S. Government and Preserving the Integrity of Financial Systems (Financial), and Managing Treasury Operations (Management). Each of the three areas of focus has one or more strategic goals with supporting objectives and performance measures that outline Treasury's approach and measured progress.

How this Report is organized

MESSAGE FROM THE SECRETARY

The Secretary's message includes an assessment of whether financial and performance data in the report is reliable and complete, and a statement of assurance as required by the Federal Managers' Financial Integrity Act (FMFIA) indicating whether management controls are in place and financial systems conform with government-wide standards. The Secretary's message sets the tone for conveying Treasury's value to the public, and establishes how the department benefits the public.

MESSAGE FROM THE ASSISTANT SECRETARY FOR MANAGEMENT/ CHIEF FINANCIAL OFFICER

The Assistant Secretary's message describes progress and challenges pertaining to the Department's financial management, including integration of budget and performance, and information on the Department's management controls program under FMFIA and financial management systems under the Federal Financial Management Improvement Act of 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Discussion and Analysis section provides a summary of the entire report. It includes a summary of the most important performance results and challenges for FY 2005; a brief analysis of financial performance; a description of systems, controls, and legal compliance; and information on the Department's progress in implementing the President's Management Agenda. **New this year: Operational Highlights describing core Treasury mission activity with supporting vignettes illustrating benefits to the American public.**

PERFORMANCE SECTION

This section contains the annual program performance information required by the Government Performance and Results Act of 1993 (GPRA) and, combined with the Appendices, includes all of the required elements of an annual program performance report as specified in OMB Circular A-11, Preparing, Submitting and Executing the Budget.

Throughout 2005, Treasury worked to simplify and improve the suite of measures reported here. There are 59% fewer performance measures reported relative to last year's report.

FINANCIAL SECTION

This section contains the Department's financial statements and related Independent Auditor's Report, and other information pertaining to the Department's financial management.

APPENDICES

This section contains more detailed information on the Department's performance results, including information on program evaluations, revisions to indicators or targets, an organizational structure, in-depth information on the Improper Payments Information Act, and information on the completeness and reliability of data.

Message from the Secretary

November 15, 2005

I am pleased to provide the Department of the Treasury's Performance and Accountability Report, presenting information on financial, management and programmatic results for Fiscal Year (FY) 2005. This report is designed to give taxpayers a picture of Treasury operations and to show how their tax dollars are being spent. The results documented here – including successes and shortcomings – will help us steer a course into the future.



In FY 2005, Treasury continued to focus on the Department's core mission as the government's premier economic agency by promoting the conditions necessary for growth and stability in the U.S. and world economies. Treasury continued to manage the government's finances while combating the financial war on terror, regulating banks and savings associations, facilitating trade, and manufacturing the nation's coins and currency. Our international efforts included critical dialogue with the Chinese government on exchange rate flexibility as well as leadership in the G7 on debt relief for heavily indebted poor countries.

The Treasury's response to the aftermath of Hurricanes Katrina and Rita showed the strength of our employees at every level as we worked as a team to help individuals and businesses regain their financial footing after the most financially devastating natural disaster in our country's history.

On the domestic front, the Department increased the use of technology to collect taxes and make payments. This year, more taxes were filed and payments disbursed electronically than ever before through improved services to the taxpayer.

Today, with a growing economy - enabled by a lower tax environment - and tightly controlled spending, we are on the right path to meeting the President's deficit reduction goals. Job creation remains strong, Gross Domestic Product is growing steadily and core inflation is largely contained. Firms are more profitable and household net worth is up. This strong growth has swelled federal tax revenue and contributed to the improved deficit picture for this year. In fact, federal tax revenues for FY 2005 have soared by 14.6% and have contributed to bringing the deficit down to 2.6% of GDP, one full percentage point less than FY 2004 and more than \$100 billion lower than expected.

We continued to implement the initiatives of the President's Management Agenda, and our progress across the PMA has improved this year. We accomplished these results by ensuring that the Treasury organization has the workforce, technology, and business practices to meet our mission for the nation. Treasury was designated a center of excellence in the delivery of financial management services. We also achieved our first "green-green" score in Competitive Sourcing and began implementing cost savings projected to save \$250 million over the next five years.

In FY 2005, Treasury changed the way we measured performance by streamlining our metrics and setting higher standards. Setting a higher bar challenged the organization and as a consequence, Treasury met fewer performance targets this year. However, the improved quality of our measures enhanced our ability to pinpoint weaknesses and promptly address challenges. In the coming year, Treasury will continue to set a high bar, address performance challenges, and ensure that the taxpayers' dollars are spent in the most effective manner.

Treasury has again received an unqualified opinion on its financial statements, which speaks to the accuracy, completeness, and reliability of the financial data in this report. Likewise, the performance data pre-

sented herein are complete and reliable. As described in the “Controls and Assurances” section of this report, Treasury needs to resolve its remaining material weaknesses in order to fully satisfy federal financial systems and control objectives. During FY 2005, we continued to emphasize the need for strong internal controls across the Department, and we will continue addressing our identified control weaknesses in FY 2006.

As we look ahead, Treasury will continue to function as a model for management and service to the American people and will continue to influence the conditions that lead to economic growth, job creation for our citizens, and keep our financial systems strong and secure.

Sincerely,

A handwritten signature in black ink, appearing to read "John W. Snow". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

John W. Snow

Message from the Assistant Secretary for Management and Chief Financial Officer

November 15, 2005



The primary mission of the Office of Management is to provide resources and support for the bureaus and offices across the Department in the performance of Treasury's diverse missions: collecting revenue, managing the government's finances, promoting prosperous and stable domestic and world economies, overseeing the nations' banking and thrift industries, fighting the war on terrorism, producing coins and currency, and ensuring the overall integrity of Treasury's operations.

Providing resources and support is accomplished through four essential activities: (1) setting goals; (2) securing needed funding to accomplish those goals; (3) providing timely financial information and guidance as funds are spent; and, (4) reporting to Congress and the public on Treasury's performance and financial results. This Performance and Accountability Report addresses the fourth activity and provides our many constituents with timely information on Treasury's actual versus planned performance, financial condition, and financial results for the year.

As a result of the dedicated efforts of the financial management staff across the Department, Treasury again received an unqualified audit opinion on its consolidated financial statements. This unqualified opinion demonstrates our accountability for the public resources entrusted to us, including over \$8 trillion in assets and liabilities, net costs of \$365 billion, budgetary resources of \$453 billion, and gross revenues of \$2.3 trillion. We accomplished this goal despite having long-standing material weaknesses in financial systems which prevent Treasury from complying fully with Federal financial systems requirements. These material weaknesses, plus others in non-financial areas, result in Treasury's providing only qualified assurance that it is meeting Federal management control objectives. We were able to close one material weakness for FY 2005, and no new weaknesses were identified, leaving us with seven to address. Several of our weaknesses involve complex systems solutions that will require several years to fix and that prevent Treasury from achieving a "green" President's Management Agenda status for financial performance. We will continue to address these weaknesses, with two scheduled for closure in FY 2006.

This report also describes the key management and performance challenges facing the Department, as identified by the Treasury Inspectors General and the Comptroller General of the United States. Treasury is committed to working with the audit community to meet these challenges.

FY 2005 saw many significant financial management accomplishments. We continued to provide timely, accurate financial information to our managers through the 3-Day Close initiative, whereby we close our books in three business days and generate financial statements and budget execution data on the fourth day following the end of each month. The Internal Revenue Service successfully installed a new administrative accounting system without any major accounting or financial reporting issues. The Bureau of Public Debt now is providing accounting system services for thirteen of our reporting components. We are migrating all of our separate travel systems to a new common e-travel system, with nine systems already migrated and the remaining five scheduled to begin migration in FY 2006. Through cross-servicing, consolidation and

streamlining, we reduced the number of financial and “mixed” program/financial systems from ninety-three in FY 2004 to sixty-eight at the end of FY 2005.

Treasury will continue to build on its progress throughout FY 2006 resulting in ever improving support for mission performance.

Sincerely,

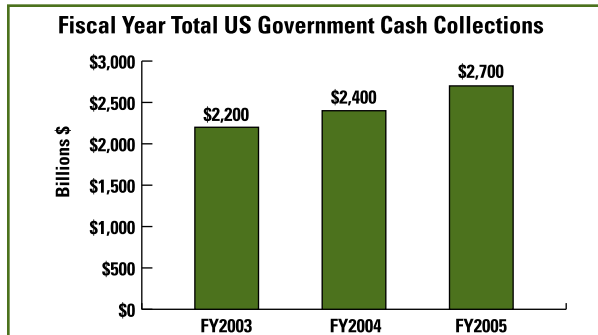
A handwritten signature in black ink that reads "Sandra L. Pack". The signature is written in a cursive, flowing style.

Sandra L. Pack

Operations Highlights

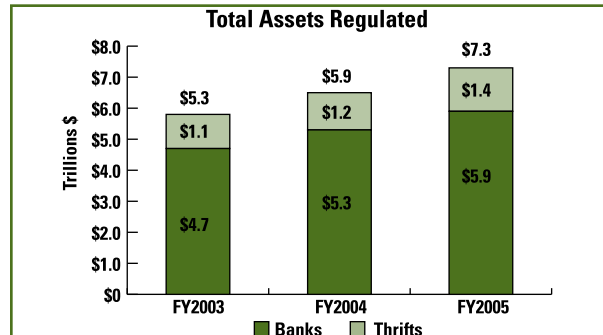
In FY2005 Treasury...

Collect



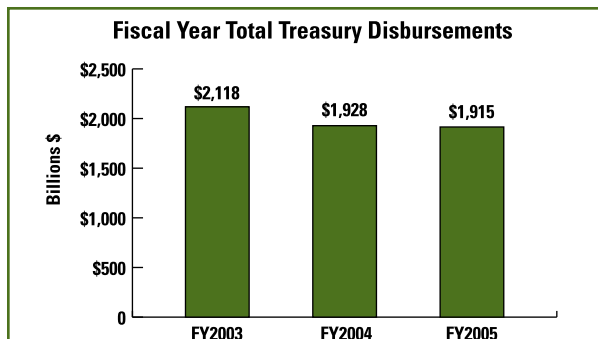
- Collected a total of \$2.7 trillion
- Collected \$47.3 billion through enforcing the tax code
- Collected \$3.24 billion in delinquent debt

Regulate



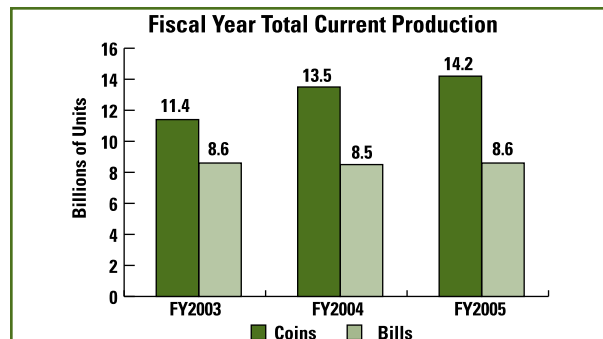
- Regulated \$7.3 trillion in national bank and savings association assets, including 2,854 national banks, federal branches and savings associations

Disburse



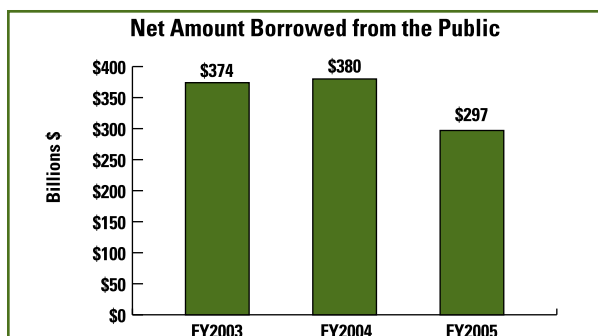
- Disbursed a total of \$1.9 trillion*
- Issued 725 million electronic bank transfers and 228 million check payments through Treasury's Regional Financial Centers

Manufacture



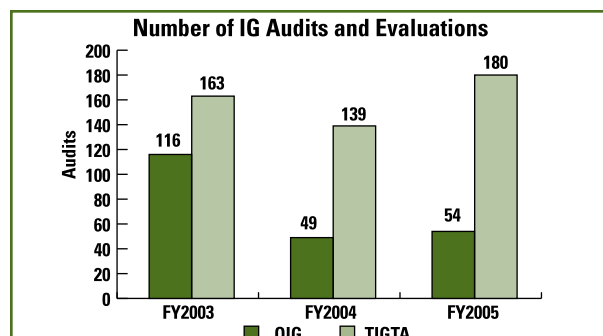
- Produced 8.6 billion currency notes
- Produced 14.2 billion coins

Borrow



- Borrowed \$297 billion (net)
- Issued \$4.5 trillion in marketable securities
- Issued 34 million savings bonds
- Paid \$352 billion in interest (includes interest credited to Trust Fund)

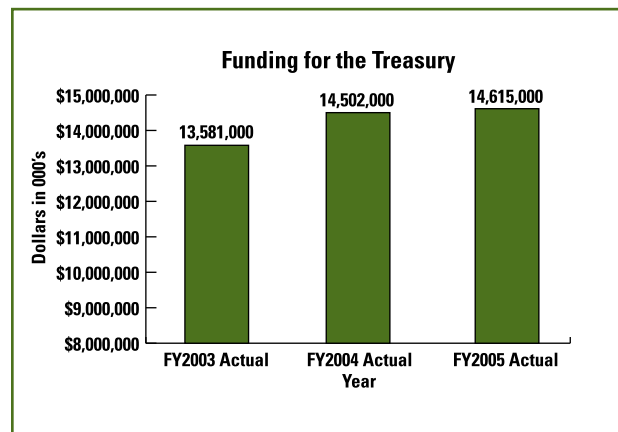
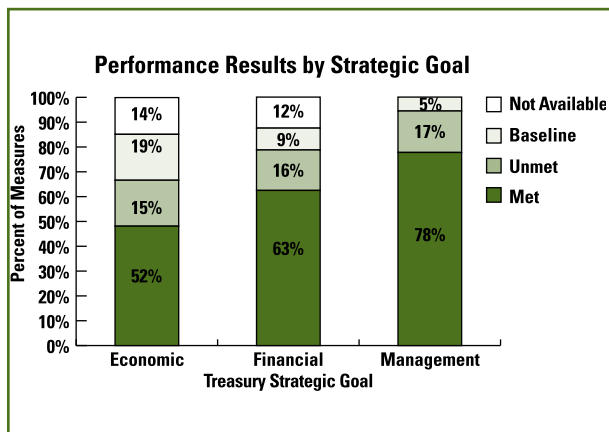
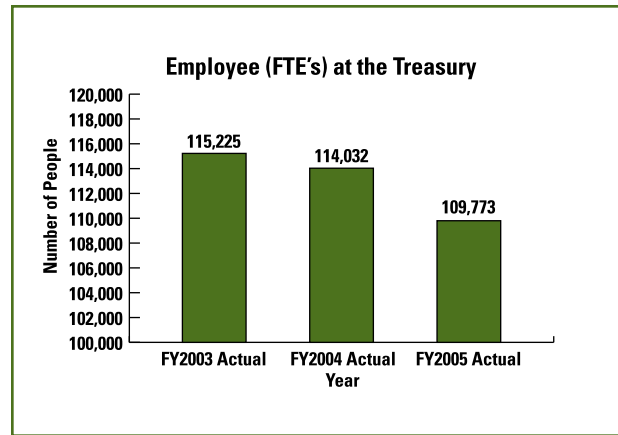
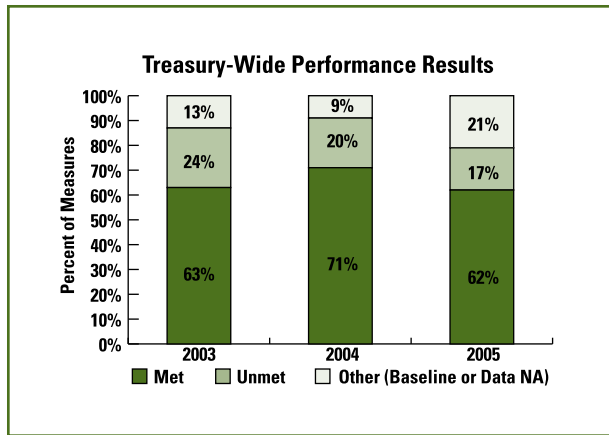
Assure



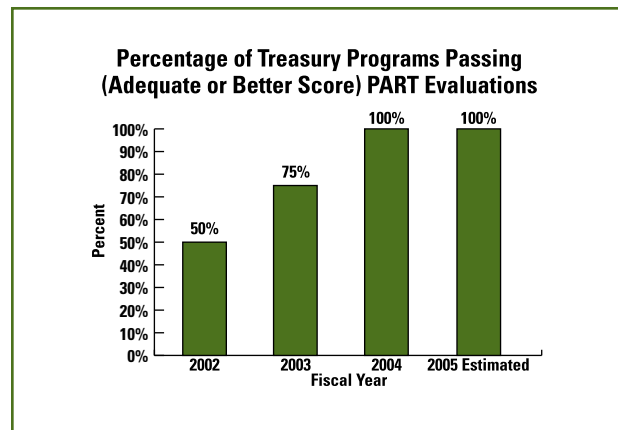
- Performed 234 audits and evaluations through the efforts of the Inspectors General

* Does not include disbursements by other agencies (i.e. Defense). Defense and State disbursed approximately \$489 billion in FY 05.

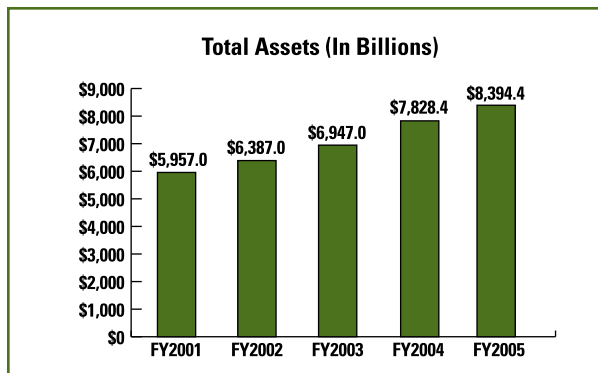
Performance Highlights



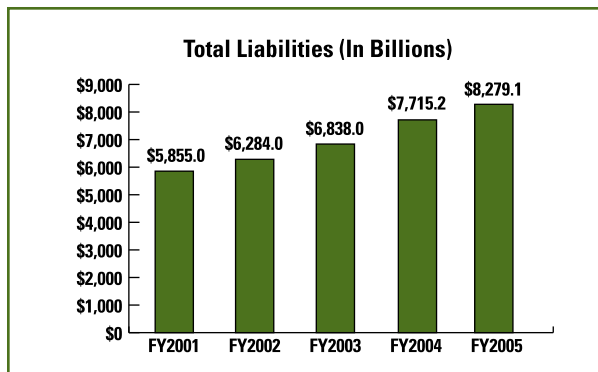
President's Management Agenda						
Initiative	Status		FY 2005 Progress			
	FY 2004	FY 2005	Q1	Q2	Q3	Q4
Human Capital	Y	Y	G	G	G	G
Competitive Sourcing	Y	G	Y	G	G	G
Financial Performance	R	R	Y	R	Y	Y
E-Government	R	R	G	G	Y	G
Budget Performance Integration	Y	Y	G	G	G	G
Improper Payments	N/A	R	N/A	G	Y	Y
● Green for Success ● Yellow for Mixed Results ● Red for Unsatisfactory						



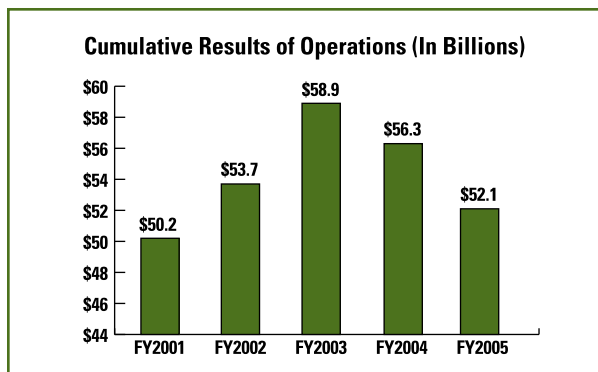
Financial Highlights



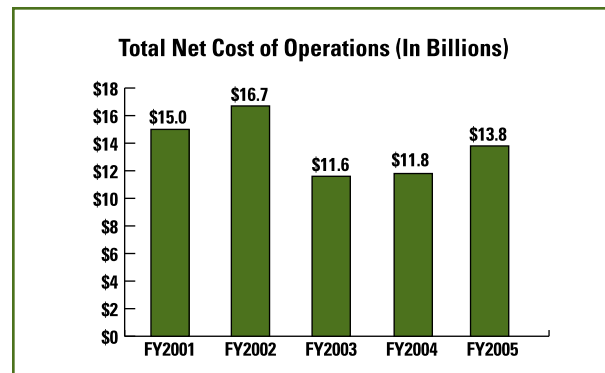
The increase in total assets from \$7.8 trillion in FY 2004 to \$8.4 trillion in FY 2005 is due to the increase in future funds required from the General Fund of the U.S. Government to pay for the federal debt.



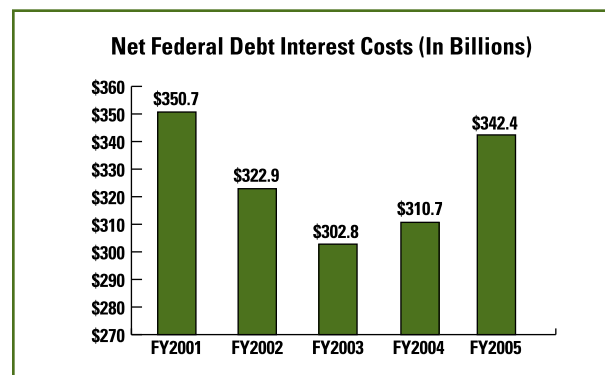
Liabilities increased primarily because borrowing from the public and other agencies to finance government operations increased by \$552 billion.



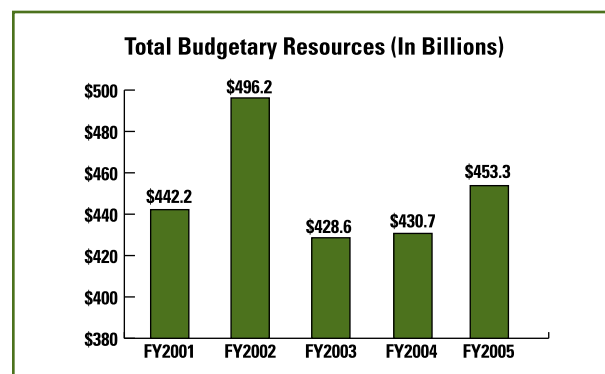
There was a net decrease of \$4.2 billion in the cumulative results of operations because of the net repayment of International Monetary Fund loans and the resultant return of funds to Treasury. There is a corresponding decrease in Treasury's position in the International Monetary Fund.



The increase of total net cost of operations from \$11.8 billion in FY 2004 to \$13.8 billion in FY 2005 is in the economic and financial programs and is due to exchange rate fluctuations, reduced interest income, write offs of discontinued projects, and increased payments to financial agents.

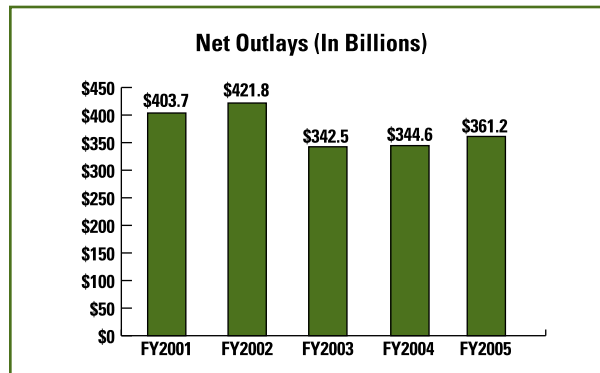


The net interest paid on the federal debt rose from \$310.7 billion in FY 2004 to \$342.4 billion in FY 2005 due to the increase in the debt and higher interest rates.

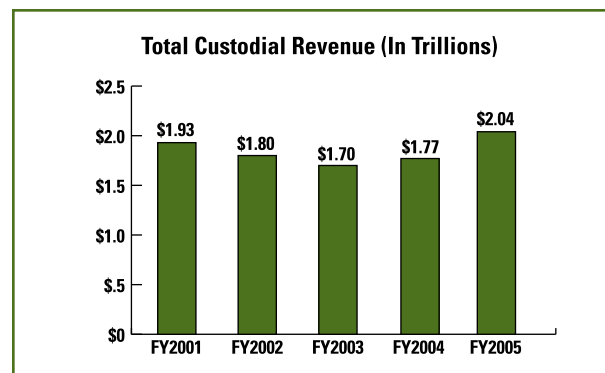


The majority of the increase in total budgetary resources from \$430.7 billion in FY 2004 to \$453.3 billion in FY 2005 was due to the increase in funding to pay for the interest on the federal debt. The sharp increase in the budgetary resources for FY 2002 was the result of a restatement to

reflect a change in accounting principles for the interest on public debt securities directed by the Office of Management and Budget.



The majority of the increase in net outlays from \$344.6 billion in FY 2004 to \$361.2 billion in FY 2005 was related to the increase in interest payments.



Total net custodial revenue collected on behalf of the U.S. Government increased from \$1.77 trillion in FY 2004 to \$2.04 trillion in FY 2005. The majority of the increase is because of the rise in individual and corporate income taxes due to increased economic activity.

Note: Prior to March 1, 2003, Treasury bureaus also included Bureau of Alcohol, Tobacco and Firearms; Federal Law Enforcement Training Center; U.S. Customs Service; and U.S. Secret Service. These bureaus were divested to either the Department of Homeland Security or Department of Justice. FY 2003 and prior years include data for these bureaus.



Part I: Management's Discussion and Analysis

Part I: Management's Discussion and Analysis

Treasury's results-oriented mission impacts every American. Treasury manages the nation's finances and produces America's coins and currency. Treasury leads efforts to strengthen the U.S. and global economy, and stands on the front line in fighting the financial war on terror.

In fiscal year 2005, Treasury had cash collections of \$2.7 trillion; processed more than 900 million payments totaling \$1.915 trillion; secured an important international agreement with China; helped to disrupt and dismantle the financial infrastructure of terrorists; and produced 14.2 billion coins and 8.6 billion paper currency notes.

Collecting Taxes

Collecting taxes in a fair and consistent manner is a core mission of the Treasury. This year, Treasury collected \$2.267 trillion in federal tax revenue from individual and corporate income taxes, a 12.3% increase over last year.

Compliance: Voluntary compliance by the citizenry is an important part of tax collection. Treasury focuses on providing quality service and education to make compliance easier. Treasury continues to expand the availability and use of e-file, with more than 50% of individual taxpayers filing their taxes electronically this past tax season. Taxpayers can find tax forms and answers to questions on the IRS's award-winning website, www.irs.gov, as well as through its toll-free telephone lines providing live operator assistance. This year, the customer service level for taxpayers calling the IRS was nearly 83%, with taxpayers receiving accurate answers to their tax questions more than 89% of the time.

Tax Reform: The President formed a bipartisan advisory panel to study the Federal Internal Revenue Code, and recommend revenue neutral policy options that would simplify and reduce the burden of compliance, as well as promote home ownership, charity, savings, and economic growth and job creation. Treasury supported the panel by providing adminis-

trative, logistical and analytical assistance. The panel delivered its report to the Secretary on November 1, 2005, and Treasury will soon present its recommendations for tax reform to the President.

e-Filing Simplifies Taxpayer Compliance



The IRS collaborates with industry and the tax professional community to improve electronic service. Through this partnership, the IRS expanded online services, increased e-filing levels and reached more taxpayers. Some large corporations and tax-exempt organizations are now required to file electronically their tax returns. To aid compliance, Treasury is launching "Modernized e-File," an enhancement to the e-File program for business return filings.

Managing U.S. Government Finances

As the government's financial manager, Treasury oversees a daily cash flow in excess of \$50 billion and distributes 85% of all federal payments. Managing the government's finances includes making payments, collecting taxes and fees, issuing debt and preparing public financial statements.

Federal Payments: Treasury issues more than 900 million payments on behalf of the federal government every year. Each federal payment costs, on average, 37 cents to issue. Treasury currently issues nearly 13.3 million paper benefit checks each month, the majority of which are Social Security payments. Treasury spends 75 cents more to print, mail, and process a paper check than to issue an electronic payment. Converting to direct deposit would save taxpayers approximately \$120 million each year.



Treasury's *Go Direct* campaign encourages Americans to use direct deposit for Social Security, Supplemental Security Income and other federal benefit payments.

The program uses advertising, teller training, and events open to the public to communicate the advantages of direct deposit.

Debt Management: Treasury manages more than \$7.9 trillion of public debt. The public debt includes marketable securities, savings bonds and other instruments held by state and local governments, federal agencies, foreign governments, corporations and individuals. To improve debt management and offer better customer service, Treasury offers "TreasuryDirect," an electronic, web-based system that electronically issues securities to retail customers and enables investors to manage their accounts online. A major initiative this year encouraged investors to convert paper savings bonds into electronic form making their investments easier to manage and to avoid potential loss or theft of the paper bonds. More than 700 million paper savings bonds are currently outstanding and could eventually be converted to TreasuryDirect.



Office of the U.S. Treasurer – Promoting Financial Education

U.S. Treasurer, Anna Escobedo Cabral, is a financial education spokesperson

for Treasury. She speaks on the importance of planning for a secure future as well as on the value of reforming Social Security to ensure its solvency for future generations.

Focusing Internationally

Treasury plays an important role in the global economy, monitoring over 160 economies to ensure stability and transparency in the global marketplace. Treasury works with foreign governments, financial institutions and international organizations to promote free and fair trade practices, identify global financial trends, and expand prosperity in the United States and around the world.



China: Treasury's international efforts included continuing dialogue and cooperation with Chinese leaders to achieve the goal of greater Chinese exchange rate flexibility. This involved discussions among senior policy officials, multilateral efforts and a Treasury-led Technical Cooperation Program. This effort helped bring about the decision by the Chinese authorities to abandon their eight-year exchange rate peg and adopt a new exchange rate mechanism, an important first step toward greater flexibility in China's exchange rate. Treasury also broadened the discussion with China to include two issues critical to continuing China's economic success: (1) fostering deeper, more open and more efficient financial markets; and (2) achieving a more balanced and sustainable pattern of growth with greater reliance on domestic demand.

Debt Relief: Debt relief is a key to formulating international economic policies that promote economic growth and poverty reduction in developing countries.

Treasury negotiated the international agreement to implement the President's proposal to cancel the debts of 38 heavily indebted poor countries (HIPC). The agreement provides one-hundred percent cancellation of debt obligations owed to the World Bank, African Development Bank, and International Monetary Fund by countries eligible for the HIPC debt relief initiative, ending the destabilizing lend-and-forgive approach to development assistance that impedes growth in low-income countries. The agreement also facilitates debt sustainability and provides additional resources to finance new development assistance.

Tsunami Relief: Treasury assisted countries affected by the tsunami of December 2004 by helping to minimize the disaster's impacts on growth and financial markets. Most importantly, Treasury supported a multilateral deferral of debt payments by Indonesia and Sri Lanka, the two countries most affected by the tsunami. This debt deferral enabled Indonesia and Sri Lanka to devote more of their financial resources to relief efforts. In addition, Treasury worked closely with the State Department to coordinate the U.S. response to the tragedy with the responses of other nation's and international organizations.

Fighting Terrorism and Financial Crime

By cutting off financing to terrorist and criminal organizations, Treasury impedes the ability of these organizations to commit crimes and carry out malicious acts that endanger the United States.

Treasury's anti-terrorist activities include coordinating financial intelligence and analysis, and promoting international relationships that attack the financial underpinnings of national security threats. To coordinate these efforts, Treasury established the Office of Terrorism and Financial Intelligence (TFI) in 2004.

TFI unifies leadership for the functions of:

- The Office of Intelligence and Analysis (OIA)
- The Office of Terrorist Financing and Financial Crimes (TFFC)

- The Financial Crimes Enforcement Network (FinCEN)
- The Office of Foreign Assets Control (OFAC)
- The Treasury Executive Office for Asset Forfeiture (TEOAF)

Treasury's range of activities against national security threats include: (1) coordinating financial intelligence and analysis, (2) promoting international relationships that attack the financial underpinnings of national security threats, (3) improving the transparency and safeguards of financial systems, and (4) targeting and sanctioning supporters of terrorism, proliferators of weapons of mass destruction, narco-traffickers and other threats.

Designations: A designation prohibits the movement of money or property by the designated entity through the world's legitimate financial system, effectively cutting the entity off from their financial assets and making it difficult to finance malicious acts against the United States. Since September 11, 2001, the United States has designated over 400 individuals or entities as terrorists or supporters of terrorists.

Designations can be used in isolation, or in concert with other enforcement actions. A notable example is the designation of certain Al Haramain Foundation offices for their support to al Qaeda. Thirteen Al Haramain offices around the world have been designated by OFAC, with U.N. designation actions following. In the most recent action, federal agents executed a search warrant on an Al Haramain office in the United States pursuant to a joint investigation by the IRS-Criminal Investigation Division, the FBI, and the Department of Homeland Security. Concurrently, Treasury's OFAC blocked the assets of the U.S. Al Haramain organization, freezing its accounts and ensuring that no money moved during the investigation.

Enforcement measures, such as designations, resulted in a noticeable deterrent to complicit donors. Intelligence reporting reveals that those previously donating money to terrorist organizations through

charitable fronts are less likely to send money after a designation action, knowing that it may expose them to investigation and possible legal action. This further erodes the financial base of the terrorists.

Money Laundering: Treasury's efforts against money laundering are another critical tool to thwart acts of terrorism. The USA PATRIOT Act and Bank Secrecy Act (BSA), among other provisions, expands the anti-money laundering system to close gaps that could be exploited by terrorists or their financiers. America is safer because of the high levels of cooperation between the public and private financial sectors. TFI analyzes financial information and reports suspicious or illegal financial activity to law enforcement agencies. Much of the anti-money laundering work is accomplished through the Bank Secrecy Act. Treasury's TFI uses a Treasury system called BSA Direct to track and share data within the enforcement community. The goal of BSA Direct is to accelerate the secure flow of financial information so that enforcement agencies can more readily use the information to prevent, detect, and prosecute financial crime, including terrorist financing.



BSA Direct Wins Golden Link Award

BSA Direct e-Filing is a system that supports electronic filing of BSA forms from a filing institution to the BSA database through a secure network. In May 2005, the system received the prestigious Golden Link Award from the Armed Forces Communication and Electronics Association. The system was selected for the award as an excellent government technology solution for reducing processing time, and providing controls to improve data accuracy, completeness and security.

Supervising National Banks and Savings Associations

Treasury, through the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS), maintains the integrity of the financial system of the United States by chartering, regulating, and supervising national banks and savings associations. In FY 2005, OCC and OTS oversaw financial assets held by these financial institutions totaling \$7.3 trillion.

OCC and OTS examiners conduct on-site reviews of financial institutions and provide sustained supervision of their operations. Both OCC and OTS issue rules, legal interpretations, and corporate decisions on the operations of the banking and thrift industries. In FY 2005, 99% of all national banks and thrifts were well capitalized relative to their risks and 94% of them earned the highest composite ratings, defined as a rating of "one or two."

Producing Coins and Currency

Producing the nation's coins and currency for domestic commerce has been a longstanding core mission of the Treasury. In FY 2005, the United States Mint (Mint) produced 14.2 billion coins and the Bureau of Engraving and Printing (BEP) produced 8.6 billion currency notes.

New designs for the nation's coins and currency were introduced during 2005. The Mint issued five new quarters from the 50 State Quarters® program, marking year six of the popular ten-year program. States honored with a quarter design in calendar year 2005 include California, Minnesota, Oregon, Kansas and West Virginia.

BEP introduced a new \$10 currency note in 2005. The new \$10 note represents the third denomination in a new currency series that incorporates background colors and improved security features designed to thwart counterfeiters. The makeover of

the \$10 note follows the similar re-design of the \$20 note in 2003 and the \$50 note in 2004. A new \$100 note is currently being developed and is planned for introduction to the public in 2007.



United States Mint Issues a Commemorative Nickel

In March of 2005, the United States Mint collaborated with a representative from the National Museum of the American Indian on Capitol Hill to display the 2005 American Bison nickels. Coin collectors had their first chance in 67 years to receive a newly designed buffalo nickel. Both sides of the coin featured new designs. The reverse of the nickel featured a sentimental rendition of a bison, similar to a previous issuance, while the obverse design featured a new, contemporary likeness of President Thomas Jefferson. The new nickel commemorated the bicentennials of the Louisiana Purchase and the Lewis and Clark expedition.

Improving Management Efficiency and Effectiveness

Treasury is improving its overall efficiency and effectiveness by implementing the President's Management Agenda (PMA), and by using the results of the Office of Management and Budget's (OMB) Program Assessment Rating Tool (PART) evaluations.

The PMA: The PMA is designed to improve management practices across the federal government and transform government into a results-oriented, effi-

cient and citizen-centered enterprise. Implementing the PMA involves: (1) lowering the cost of doing business through competition; (2) strengthening Treasury's workforce; (3) improving financial performance; (4) increasing the use of information technology and e-Government capabilities; and (5) integrating budget decisions with performance data.

The Office of Management and Budget assesses each agency's status and progress for the PMA initiatives on a quarterly basis. Initiative "status" describes overall success, and "progress" describes ongoing efforts to meet PMA goals.

Initiative	Status		FY 2005 Progress			
	FY 2004	FY 2005	Q1	Q2	Q3	Q4
Human Capital	Y	Y	G	G	G	G
Competitive Sourcing	Y	G	Y	G	G	G
Financial Performance	R	R	Y	R	Y	Y
E-Government	R	R	G	G	Y	G
Budget Performance Integration	Y	Y	G	G	G	G
Improper Payments	N/A	R	N/A	G	Y	Y

● Green for Success
 ● Yellow for Mixed Results
 ● Red for Unsatisfactory

In FY 2005, Treasury achieved a "green-green" score in Competitive Sourcing. This was Treasury's first "green-green." Competitive sourcing across Treasury has resulted in projected cost-avoidance of \$250 million over the next five years. The Competitive Sourcing team also earned the President's Quality Award for management excellence and exemplary performance for efforts on the IRS's Area Distribution Center competitive sourcing study.

Treasury's Human Capital and Budget Performance Integration initiatives remained yellow, while E-Government remained red. All three initiatives are targeting green status in FY 2006. More time is needed to achieve an improved score in Financial Performance and Eliminating Improper Payments (both are scored red), an important priority.

Program Assessment Rating Tool (PART): OMB's PART is intended to improve program performance. Treasury made a strong commitment to improve its program performance, and PART scores improved 36% compared to last year (final scores pending at the time of publication). Currently, 82% of Treasury's PART evaluations scored "adequate" or better, and Treasury is targeting 90% in FY 2006.

Summary of Management Challenges and High-Risk Areas

The Treasury's Inspectors General and the Government Accountability Office (GAO) have identified the following areas as being Treasury's most significant challenges and having high-risk:

- Corporate Management
- Management of Capital Investments
- Information Security
- Linking Resources to Results
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Bringing IRS Financial Management Systems into Compliance with FFMIA
- Preparing Reliable Financial Statement for the U.S. Government
- Enforcement of Tax Laws
- Modernization of the Internal Revenue Service
- Tax Compliance Initiatives
- Security of the Internal Revenue Service
- Complexity of the Tax Law
- Processing Returns and Implementing Tax Law Changes During the Tax Filing Season
- Improving Service to Taxpayers - Providing Quality Customer Service Operations
- Taxpayer Protection and Rights
- Human Capital

Treasury has taken many positive actions to address these challenges during FY 2005 and will continue

to work with its Inspectors General and the GAO to address them in FY 2006.

Hurricane Relief Efforts

The size, scope and ferocity of hurricanes Katrina and Rita were unprecedented and the federal response and recovery efforts have been extensive. Treasury's role in the effort has focused on helping individuals and businesses regain their financial footing.

In the days leading up to hurricane Katrina's land-fall, senior Treasury officials convened to facilitate a Treasury response. Treasury sought to ensure timely recovery of the financial sector and alleviate disruption of federal benefit payments. In the days immediately after Hurricane Katrina, 4,100 IRS telephone operators assisted the Federal Emergency Management Agency (FEMA) by answering telephone calls and relaying information for those affected.

Payments: Treasury worked to expedite the delivery of benefit and disaster assistance payments to hurricane evacuees, including Social Security and Supplement Security Income payments. Revised processes ensured that benefits would not be canceled even though Social Security checks could not be delivered. Treasury issued 1.2 million electronic payments totaling \$2.6 billion to aid hurricane victims and recovery efforts. And to provide victims with money quickly, Treasury delivered to FEMA more than 11,000 debit cards, preloaded with \$2,000 each for distribution.

National Banks and Savings Associations: Hurricane Katrina directly affected 43 national banks and savings associations, including nearly 600 branch locations, with total deposits in excess of \$25.5 billion. Treasury worked to ensure that people and businesses had access to the banking and financial systems immediately after the hurricane. At relief centers across the region, Treasury worked to ensure availability of mobile banking services. Treasury

also worked with financial institutions to streamline check-cashing procedures to ensure benefit checks were honored and to ease temporarily restrictions on cashing out-of-state checks. Treasury also asked banks and savings associations to waive ATM fees, increase daily cash withdrawal limits, and waive credit card late charges. In some instances, Treasury was able to work with banking supervisors and regulators to allow depository institutions to co-locate so that financial institutions whose branches were destroyed by Katrina could serve their customers from another institution's branch location.

Economic Development: Treasury implemented changes to the New Markets Tax Credit (NMTC) program in areas affected by Hurricane Katrina, thereby encouraging new investment in the region. Some of these changes included extending application deadlines for applicants directly impacted by the disaster, and giving additional consideration to organizations that commit to target their investments within the disaster region.

Tax Relief: Treasury is sensitive to the burden of tax compliance for victims displaced from their homes, employment or financial assets. To ease the tax compliance burden, the IRS took the following actions:

- Extended the upcoming filing deadlines for quarterly tax payments to February 28, 2006 for filing returns and making tax payments or deposits
- Waived the fees and expedited the fulfillment of requests for copies of previously-filed tax returns to enable victims to apply for benefits, or to file amended 2004 tax returns to claim disaster-related losses
- Eased tax rules pertaining to retirement savings in 401(k) and 403(b) plans, and permitted victims to withdraw hardship disbursements or use those assets as collateral for loans
- Suspended low-income housing tax credit rules so that owners of those properties could provide housing to Katrina victims who did not qualify as "low-income." This action greatly expanded the availability of housing for disaster victims and their families

Conclusion

During FY 2005, Treasury helped advance many of the important international goals of the United States by, among other things, working to stop the flow of funds to terrorists, drug cartels and other criminal groups; improving access to global markets; and reducing third world poverty. Also during FY 2005, Treasury improved domestic fiscal management by working to reform tax policy; upgrading the government's financial management; supervising the nation's banking system; and efficiently producing all of the nation's coins and currency.

Treasury's high-profile activities during FY 2005 also included minimizing the economic damage of devastating international and domestic natural disasters, namely the tsunami of December 2004, and Hurricanes Katrina and Rita. In the coming years, as Treasury continues to improve its efficiency and effectiveness, the Department will remain an important player on the international and domestic stage.

Analysis of Financial Statements

Auditors' Report on Treasury's Financial Statements

Treasury again received an unqualified audit opinion on its consolidated financial statements: Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, Statements of Financing, Statements of Custodial Activity, and combining Statements of Budgetary Resources. The auditors' report contains two reportable conditions concerning weaknesses in financial management and reporting (a material weakness) and electronic data processing controls. The report also addresses two instances of noncompliance with laws and regulations: The release of liens on taxpayers' property is not always accomplished within statutory time frames, and Treasury's financial management systems do not substantially comply with Federal systems requirements. The basic financial statement are included in these "Highlights;" the auditors' report and complete financial statements are included in Part III of the full report.]

Limitations on the Principal Financial Statements

These statements have been prepared from the accounting records of Treasury in conformity with the accounting principles generally accepted in the United States, and the form and content of entity financial statements specified by OMB Circular A-136, Financial Reporting Requirements, as amended. These principles are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is designated the official accounting standards setting body of the Federal government by the American Institute of Certified Public Accountants.

While the financial statements have been prepared from the books and records of the entity, in accordance with the formats prescribed by OMB, they are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

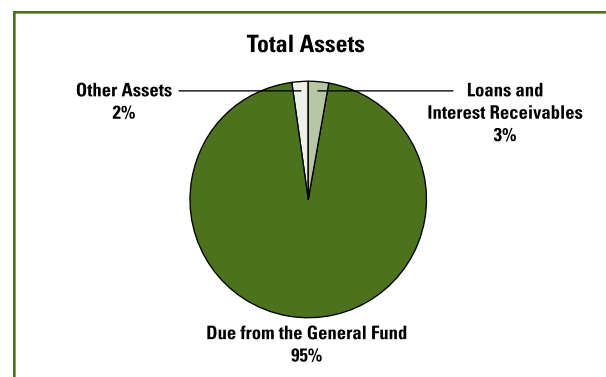
The financial statements should be read with the realization that they are for a component of a sover-

eign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

Analysis of Financial Statements

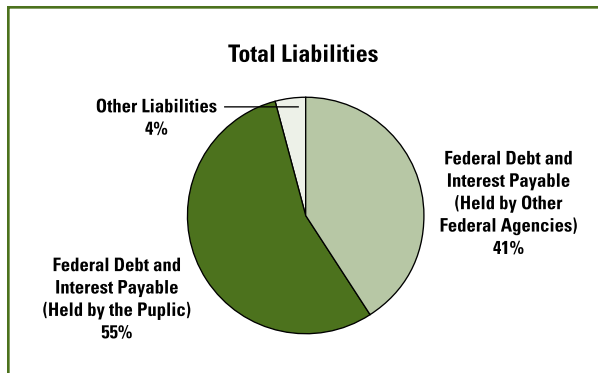
The following provides the highlights of Treasury's financial position and results of operations in FY 2005. A complete set of financial statements, accompanying notes, and the audit opinion can be found in the complete Performance and Accountability Report for FY 2005.

Assets. Total assets increased from \$7.8 trillion at September 30, 2004 to \$8.4 trillion at September 30, 2005. The primary reason for the increase is the rise in the federal debt, which causes a corresponding rise in the "Due from the General Fund of the U.S. Government" account. This account represents future funds due from the General Fund of the U.S. Government to pay borrowings from the public and other federal agencies.

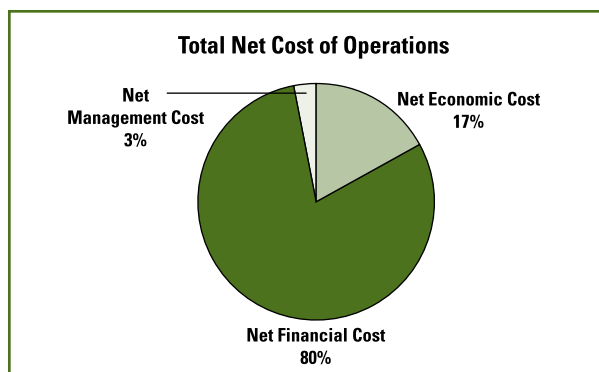


Liabilities: Intra-governmental liabilities totaled \$3.6 trillion, and include \$3.4 trillion of principal and interest payable to various Federal agencies such as the Social Security Trust Fund. These borrowings do not include debt issued separately by other governmental agencies, such as the Tennessee Valley Authority or the Department of Housing and Urban Development.

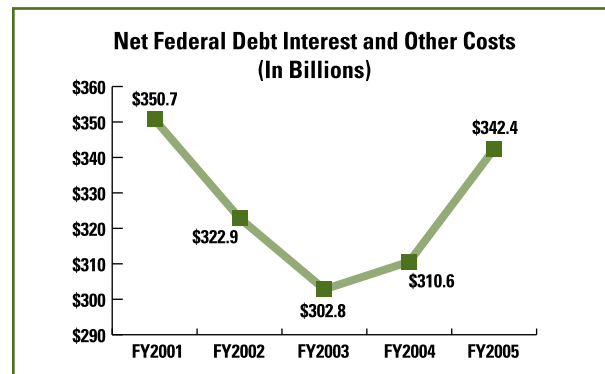
Liabilities also include federal debt held by the public, including interest, of \$4.6 trillion; the majority of this debt was issued as Treasury Notes. The increase in total liabilities in FY 2005 over FY 2004 (\$564 billion and 7.3%), is the result of increases from borrowing from various federal agencies (\$257 billion), and federal debt held by the public, including interest (\$295 billion). Debt held by the public increased primarily because of the need to finance budget deficits.



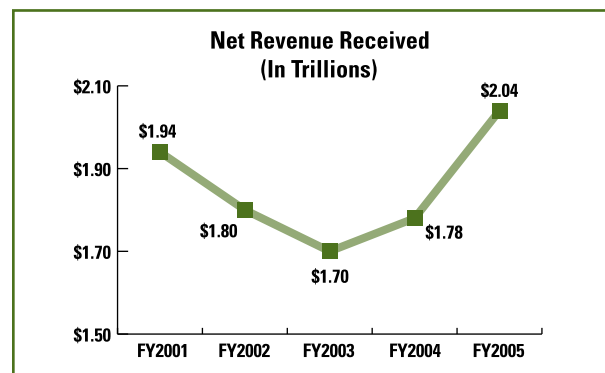
Net Cost of Treasury Operations: The Consolidated Statement of Net Cost presents the Department's gross and net cost for its three strategic missions: financial focus, economic focus, and management focus. The majority of the net cost of Treasury operations is in the financial mission area. Treasury is the primary fiscal agent for the Federal government in managing the Nation's finances by collecting revenue, making Federal payments, managing Federal borrowing, performing central accounting functions, and producing coins and currency sufficient to meet the demand.



Net Federal Debt Interest Costs: Interest costs have increased significantly (10.2%) over the past two years due to the increase in the federal debt.



Custodial Revenue: Total net revenue collected by Treasury on behalf of the federal government includes various taxes, primarily income taxes, user fees, fines and penalties, and other revenue. Over 90 percent of the revenues are from income and social security taxes. After remaining relatively flat the past few years, net revenue increased by 15% in FY 2005 due to increased economic activity.



Consolidated Balance Sheets
As of September 30, 2005 and 2004
(In Millions)

	2005	2004
ASSETS		
Intra-governmental Assets		
Fund Balance	\$66,334	\$59,946
Loans and Interest Receivable	228,491	214,065
Advances to the Black Lung Trust Fund	9,186	8,741
Due From the General Fund	7,978,081	7,420,492
Accounts Receivable and Related Interest	626	632
Other Intra-governmental Assets	40	12
Total Intra-governmental Assets	8,282,758	7,703,888
Cash, Foreign Currency, and Other Monetary Assets	47,578	53,161
Gold and Silver Reserves	10,933	10,933
Loans and Interest Receivable	670	977
Investments and Related Interest	9,404	10,870
Reserve Position in the International Monetary Fund	13,247	19,442
Investments in International Financial Institutions	5,464	5,403
Tax, Other, and Related Interest Receivable, Net	21,430	20,520
Inventory and Related Property, Net	468	459
Property, Plant, and Equipment, Net	2,398	2,745
Other Assets	22	24
Total Assets	\$8,394,372	\$7,828,422
LIABILITIES		
Intra-governmental Liabilities		
Federal Debt and Interest Payable	\$3,354,905	\$3,097,949
Other Debt and Interest Payable	14,164	0
Due to the General Fund	273,551	276,436
Other Intra-governmental Liabilities	422	935
Total Intra-governmental Liabilities	3,643,042	3,375,320
Federal Debt and Interest Payable	4,600,668	4,305,302
Certificates Issued to Federal Reserve Banks	2,200	2,200
Allocation of Special Drawing Rights	7,102	7,197
Gold Certificates Issued to Federal Reserve Banks	10,924	10,924
Refunds Payable	1,952	1,808
D.C. Pension Liability	8,511	8,367
Other Liabilities	4,665	4,146
Total Liabilities	8,279,064	7,715,264
Commitments & Contingencies		
NET POSITION		
Unexpended Appropriations	63,182	56,850
Cumulative Results of Operations	52,126	56,308
Total Net Position	115,308	113,158
Total Liabilities and Net Position	\$8,394,372	\$7,828,422

Consolidated Statements of Net Cost
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
COST OF TREASURY OPERATIONS		
Economic Program		
Gross Cost	\$3,066	\$3,019
Less Earned Revenue	(782)	(1,687)
Net Program Cost	<u>2,284</u>	<u>1,332</u>
Financial Program		
Gross Cost	15,580	14,737
Less Earned Revenue	(4,487)	(4,711)
Net Program Cost	<u>11,093</u>	<u>10,026</u>
Management Program		
Gross Cost	1,156	947
Less Earned Revenue	(739)	(525)
Net Program Cost	<u>417</u>	<u>422</u>
Total Program Gross Costs	19,802	18,703
Total Program Gross Earned Revenues	(6,008)	(6,923)
Total Net Cost of Operations	<u>13,794</u>	<u>11,780</u>
FEDERAL COSTS:		
Federal Debt Interest	354,386	322,142
Less Interest Revenue from Loans	(11,984)	(11,500)
Net Federal Debt Interest Costs	<u>342,402</u>	<u>310,642</u>
Other Federal Costs	8,673	12,915
Net Federal Costs	<u>351,075</u>	<u>323,557</u>
Interests, and Other Federal Costs	<u>\$364,869</u>	<u>\$335,337</u>

Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2005
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	\$56,308	\$56,850
Budgetary Financing Sources		
Appropriations Received		369,312
Appropriations Transferred In/Out		(594)
Other Adjustments		(319)
Appropriations Used	362,067	(362,067)
Non-exchange Revenue	53	
Donations and Forfeitures of Cash and Cash Equivalents	169	
Other Financing Sources		
Donations and Forfeitures of Property	51	
Accrued Interest & Discount on the Debt	9,879	
Transfers In/Out Without Reimbursement	(133)	
Imputed Financing Sources	722	
Transfers to the General Fund and Other	(12,104)	
Total Financing Sources	360,687	6,332
Net Cost	(364,869)	
Ending Balances	\$52,126	\$63,182

Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2004
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	\$58,925	\$50,433
Budgetary Financing Sources		
Appropriations Received		347,808
Appropriations Transferred In/Out		214
Other Adjustments		(400)
Appropriations Used	341,205	(341,205)
Non-exchange Revenue	45	
Donations and Forfeitures of Cash and Cash Equivalents	119	
Transfers In/Out Without Reimbursement	(42)	
Other Budgetary Financing Sources	(4)	
Other Financing Sources		
Donations and Forfeitures of Property	31	
Accrued Interest & Discount on the Debt	3,481	
Transfers In/Out Without Reimbursement	(38)	
Imputed Financing Sources	714	
Transfers to the General Fund and Other	(12,791)	
Total Financing Sources	332,720	6,417
Net Cost	(335,337)	
Ending Balances	\$56,308	\$56,850

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
BUDGETARY RESOURCES		
Budgetary Authority		
Appropriations Received	\$379,567	\$352,212
Borrowing Authority	331	30
Net Transfers	99	(809)
Unobligated Balance:		
Beginning of the Period	69,912	73,859
Net Transfers	(629)	(39)
Spending Authority from Offsetting Collections		
Earned		
Collected	6,286	7,328
Receivable from Federal Sources	36	(1)
Change in Unfilled Customer Orders		
Advance Received	(29)	(9)
Without Advance from Federal Sources	(81)	290
Subtotal	6,212	7,608
Recoveries of Prior Year Obligations	1,286	338
Temporarily Not Available Pursuant to Public Law	1,957	(322)
Permanently Not Available	(5,403)	(2,180)
Total Budgetary Resources	\$453,332	\$430,697
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	\$384,853	\$357,046
Reimbursable	3,809	3,739
Subtotal	388,662	360,785
Unobligated Balance:		
Apportioned	14,576	14,365
Exempt for Apportionment	40,084	45,368
Unobligated Balance Not Available	10,014	10,179
Total Status of Budgetary Resources	\$453,332	\$430,697

(Continued)

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Obligated Balance, Net, Beginning of the Period	\$41,446	\$35,018
Obligated Balance, Net, End of the Period		
Accounts Receivable	(211)	(173)
Unfilled Customer Orders from Federal Sources	(432)	(513)
Undelivered Orders	44,722	40,430
Accounts Payable	1,659	1,702
Outlays		
Disbursements	383,128	353,729
Collections	(6,258)	(7,319)
Subtotal	376,870	346,410
Less: Offsetting Receipts (Note 21)	(15,649)	(1,828)
Net Outlays	\$361,221	\$344,582

Consolidated Statements of Financing
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Obligations Incurred	\$388,662	\$360,785
Less: Spending Authority from Offsetting Collections and Recoveries	(7,498)	(7,946)
Obligations Net of Offsetting Collections and Recoveries	381,164	352,839
Less: Offsetting Receipts	(15,649)	(1,828)
Net Obligations	365,515	351,011
Other Resources		
Donations and Forfeiture of Property	51	31
Accrued Interest & Discount on the Debt	9,879	3,481
Transfers In/Out Without Reimbursement	(133)	(38)
Imputed Financing Sources	722	714
Transfers to the General Fund and Other	(12,104)	(12,791)
Net Other Resources Used to Finance Activities	(1,585)	(8,603)
Total Resources Used to Finance Activities	363,930	342,408
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided	4,384	6,713
Resources that Fund Expenses Recognized in Prior Periods	432	243
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of		
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	(7)	(128)
Other	(15,677)	(1,150)
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	522	563
Adjustment to Accrued Interest & Discount on the Debt	7,313	2,590
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	2,060	(479)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(976)	(8,352)
Total Resources Used to Finance the Net Cost of Operations	\$364,903	\$334,056

(Continued)

Consolidated Statements of Financing
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIODS		
Components of Net Cost of Operations Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	\$9	\$24
Upward Reestimates of Credit Subsidy Expense	1	328
Increase in Exchange Revenue Receivable from the Public	(2)	0
Other	141	90
	<hr/>	<hr/>
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	149	442
Components of Net Cost of Operations that will not Require or Generate Resources		
Depreciation and Amortization	612	529
Revaluation of Assets or Liabilities	(714)	323
Other	(81)	(13)
	<hr/>	<hr/>
Total Components of Net Cost of Operations that will not Require or Generate Resources	(183)	839
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	<hr/> (34)	<hr/> 1,281
Net Cost of Operations	<hr/> \$364,869	<hr/> \$335,337

Statements of Custodial Activity
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
Revenue Received		
Individual and FICA Taxes	\$1,864,687	\$1,695,212
Corporate Income Taxes	306,869	230,377
Estate and Gift Taxes	25,605	25,580
Excise Taxes	71,970	69,552
Railroad Retirement Taxes	4,539	4,421
Unemployment Taxes	6,948	6,718
Deposit of Earnings, Federal Reserve System	19,297	19,652
Fines, Penalties, Interest & Other Revenue	3,552	2,456
Total Revenue Received	2,303,467	2,053,968
Less Refunds	(267,114)	(278,436)
Net Revenue Received	2,036,353	1,775,532
Accrual Adjustments	(643)	(1,938)
Total Custodial Revenue	2,036,996	1,773,594
DISPOSITION OF CUSTODIAL REVENUE AND COLLECTIONS		
Amounts Provided to Fund Non-Federal Entities	454	612
Amounts Provided to Fund the Federal Government	2,035,899	1,774,920
Accrual Adjustment	643	(1,938)
Total Disposition of Custodial Revenue	2,036,996	1,773,594
Net Custodial Revenue Activity	\$0	\$0

Improper Payments Information Act and Recovery Act

Background

The Improper Payments Information Act of 2002 (IPIA) requires agencies to annually review their programs and activities to identify those that are susceptible to significant erroneous payments. “Significant” means that an estimated error rate and a dollar amount exceed the threshold of 2.5% and \$10 million of total program funding.

Some Federal programs are so complex that developing an annual error rate is not feasible. The government-wide Chief Financial Officers Council developed an alternative for such programs to assist them in meeting the IPIA requirements. Agencies may establish an annual estimate for a high-risk component of a complex program (e.g., a specific program population) with Office of Management and Budget (OMB) approval. Agencies must also perform trend analyses to update the program’s baseline error rate in the interim years between detailed program studies. When development of a statistically valid error rate is possible, the reduction targets are revised and become the basis for future trend analyses.

Treasury’s Risk Assessment Methodology

Each year, a comprehensive inventory of the funding sources for all programs and activities is developed. If program or activity funding is at least \$10 million, Risk Assessments are required at the payment type level (e.g., payroll, contracts, vendors, travel, etc.). For those payment types resulting in high risk assessments that comprise at least 2.5% and \$10 million of a total funding source, (1) statistical sampling must be performed to determine the actual improper payment rate, and (2) a Corrective Action Plan must be developed and submitted to the Office of Management and Budget for approval.

Results for FY 2005

All of Treasury’s programs and activities resulted in low and medium risk susceptibility for improper payments except for the Internal Revenue Service’s (IRS) Earned Income Tax Credit (EITC) program. The

high-risk status of this program is well-documented and has been deemed a complex program for the purposes of the Improper Payments Information Act.

Earned Income Tax Credit

The Earned Income Tax Credit is a refundable tax credit that offsets income tax owed by low-income taxpayers and, if the credit exceeds the amount of taxes due, provides a lump-sum payment in the form of a refund to those who qualify. The FY 2005 estimate is that a maximum of 28% (\$11.4 billion) and a minimum of 23% (\$9.6 billion) of the EITC total program payments are overclaims.

Since June 2003, IRS has focused on reducing EITC overclaims through a five-point initiative designed to:

- Reduce the backlog of pending EITC examinations
- Minimize the burden and enhance the quality of communications with taxpayers
- Encourage eligible taxpayers to claim the EITC
- Ensure fairness by refocusing compliance efforts on income-ineligible taxpayers
- Pilot a certification effort to substantiate qualifying child residency eligibility

Recovery Act

Background

The Recovery Act requires agencies issuing in excess of \$500 million in contracts to establish and maintain recovery auditing activities and report on the results of those recovery efforts annually. Recovery auditing activities include the use of (1) contract audits, in which an examination of contracts pursuant to the audit and records clause incorporated in the contract is performed, (2) contingency contracts for recovery services in which the contractor is paid a percentage of the recoveries, and (3) internal review and analysis in which payment controls are employed to ensure that contract payments are accurate.

Results for FY 2005

During FY 2005, \$4.9 billion in contracts (defined as issued and obligated contracts, modifications, task orders, and delivery orders) were issued. Improper payments in the amount of \$428,977 were identified from recovery auditing efforts and, of this amount, \$364,680 has been recovered with \$64,297 outstanding as accounts receivable on September 30, 2005.

Systems, Controls and Audit Follow-up

The Secretary's Letter of Assurance

The Department of the Treasury has evaluated its management controls and compliance with Federal financial systems standards. The results of independent audits were considered as part of Treasury's evaluation process. As a result of our evaluations, Treasury can provide reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act have been achieved, except for the remaining material weaknesses noted below. However, Treasury is not in substantial compliance with the Federal Financial Management Improvement Act because of its remaining material weaknesses involving financial systems.

Treasury has seven remaining material weaknesses as of September 30, 2005. The weaknesses are in the following areas:

Internal Revenue Service

- Collecting unpaid tax liabilities
- Improving systems modernization management and controls
- Reducing overclaims in the Earned Income Tax Credit program
- Improving systems security controls
- Resolving deficiencies in revenue accounting systems

Financial Management Service

- Improving systems, controls, and procedures to prepare the Government-wide financial statements

Departmental Offices

- Complying with systems security

Treasury began the year having eight material weaknesses, and closed one. No new material weaknesses were identified in FY 2005. We are continually achieving positive results through:

- emphasizing management control program responsibilities throughout Treasury.
- ensuring senior management attention to management controls.
- focusing on the need to develop and carry out responsible plans for resolving weaknesses.

I am confident that Treasury's progress will continue in FY 2006.

Sincerely,



John W. Snow

Federal Managers' Financial Integrity Act (FMFIA)

The management control objectives under FMFIA are to ensure that:

- programs achieve their intended results
- resources are used consistent with overall mission
- programs and resources are free from waste, fraud and mismanagement
- laws and regulations are followed
- controls are sufficient to minimize any improper or erroneous payments
- performance information is reliable
- system security is in substantial compliance with all relevant requirements
- continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels
- financial management systems are in compliance with Federal financial systems standards

Deficiencies that seriously affect an agency's ability to meet these objectives are deemed "material weaknesses." Treasury can provide reasonable assurance that the objectives of FMFIA have been achieved, except for the remaining material weaknesses noted in the Secretary's Letter of Assurance above. During FY 2005, Treasury had a decrease of one material weakness. Seven material weaknesses are outstanding as of September 30, 2005. Of the seven remaining, two are projected to be closed in FY 2006. The remaining five are complex systems or systems security weaknesses, and will require a more protracted timeframe to resolve. The last currently identified material weakness is scheduled to be closed in FY 2009.

The Department of the Treasury continues to strengthen and improve the execution of our mission through the application of sound internal controls. During FY 2005, the Office of Management and

Budget (OMB) issued final revisions to OMB Circular A-123, *Management's Responsibility for Internal Controls*. One of the key areas of revision is assessing and documenting internal controls over Financial Reporting, similar to those mandated for the private sector under the Sarbanes-Oxley Act. Treasury established a work group to develop a Department-wide approach to address the requirements of the revised OMB Circular.

Material weaknesses, both the resolution of existing ones and the prevention of new ones, received special attention during FY 2005. Over the past five years, we have made great progress in reducing the number of material weaknesses Treasury-wide. During FY2006, we will solicit Department-wide support for continuing our path of no new material weaknesses and focusing our attention on preventing them before they occur.

Federal Financial Management Improvement Act (FFMIA)

FFMIA mandates that agencies "... implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level." FFMIA also requires that remediation plans be developed for any entity that is unable to report substantial compliance with these requirements.

As of September 30, 2005, Treasury is not in substantial compliance with these requirements due to the revenue accounting system weaknesses at the Internal Revenue Service. The Department received approval from OMB in 2001 to extend the 3-year statutory time frame addressing the weaknesses, which are scheduled to be corrected by May 2007. Despite some slippage, the Department continues to make progress with the implementation of its remediation plans.

Audit Follow-Up

During FY 2005, Treasury continued its efforts to improve both the general administration of management control issues throughout the Department and the timeliness of the resolution of all findings and recommendations identified by the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), the Government Accountability Office, and external auditors. During the year, Treasury continued its effort to provide enhancement to the tracking system called the "Joint Audit Management Enterprise System" (JAMES). JAMES is a Department-wide, interactive, on-line, real-time system accessible to the OIG, TIGTA, Bureau Management, Departmental Management, and others. The system contains tracking information on audit reports from issuance through completion of all actions required to address all findings and recommendations contained in a report.

At the beginning of FY 2005, Treasury had identified corrective actions for 40 audit reports with \$8,061.2 million in potential monetary benefits. Corrective actions were identified for 38 new audit reports having \$83,422.4 million in potential benefits. Thirty-three reports with potential benefits of \$74,968.9 million were closed; \$81.0 million of the benefits were realized and \$74,887.9 million of potential benefits was not realized. At the end of FY 2005 there were 41 such open audit reports having potential benefits of \$16,514.7 million.

Treasury management at every level will maintain the momentum on accomplishing Planned Corrective Actions (PCAs) to resolve and implement sound solutions for all audit recommendations, and it is understood that we have considerably more work to do. Specifically, we must provide timely and accurate performance in addressing PCA schedules and

implementation and integrate the effects of those actions more fully into our management decision-making processes. We need to identify more precisely what it costs to accomplish our varied missions and develop ways to improve overall performance. This will entail building upon the progress we have made in expanding the communication and coordination among offices variously involved in strategic planning, budget formulation, budget execution, performance management and financial management.

Financial Management Systems Framework

Treasury's overall financial systems framework consists of a Treasury-wide financial data warehouse supported by separate bureau systems. Bureaus submit financial data to the data warehouse on a monthly basis. This framework satisfies both the bureaus' diverse financial operational and reporting needs as well as Treasury's reporting requirements. The financial data warehouse is part of the overarching Treasury-wide Financial Analysis and Reporting System, which also includes systems for bureau reporting of performance data, audit follow-up information, and activities performed by government personnel.

Treasury has continued to streamline and reduce the number of financial management systems. The number of systems was reduced to 68 at September 30, 2005 from 93 at the end of fiscal year 2004. In addition, thirteen of Treasury's twenty-four reporting entities are being cross-served by the Bureau of Public Debt's Administrative Resource Center (ARC) for their financial systems needs. In addition, ARC is also providing support to nine Treasury bureaus with the processing of their travel needs as part of the Department's e-Travel initiative. Five bureaus are scheduled for e-Travel implementation beginning in fiscal year 2006.

Possible Future Effects of Existing Events and Conditions

The following paragraphs highlight the most significant issues facing Treasury and their possible impact on Treasury, the Federal Government, and the public.

Fighting the Financial War on Terrorism

Terrorism is the single biggest threat to our national security and economic well being. If not combated effectively, terrorism has the potential to severely disrupt economic activity and negatively affect the lives of all Americans. The war on terrorism is being successfully waged on many fronts. Treasury is fighting on the financial front, and our recently created Office of Terrorism and Financial Intelligence is leading the fight. Terrorists need money to finance their destructive activities, and the means to move that money quickly to terrorist cells around the globe. Treasury is relentlessly working to dismantle the financial infrastructure of terrorism through several means at our disposal. By designating individuals or entities as terrorists or terrorist supporters, Treasury prohibits the movement of money or property through U.S. and international financial systems. Terrorist bank accounts are frozen to prevent the removal of funds while investigations are ongoing. Enforcement measures are proving effective in shutting down financial channels and as a deterrent to would-be donors to terrorist organizations. Treasury has bolstered its financial intelligence capabilities through the recent creation of a separate office dedicated to this purpose. And, aided by the provisions of the USA PATRIOT Act, the Bank Secrecy Act, and cooperation between the public and private financial sectors, Treasury is working successfully to stop terrorist money-laundering activities.

Improving Compliance with the Internal Revenue Code

The Tax Gap: Closing the tax gap, the difference taxes that should be paid and what is actually collected, is at the heart of the IRS's renewed emphasis on enforcement. The IRS will continue to expand enforcement by targeting its case work and enforcement activities to deliver results more effectively and drive down the

tax gap. The IRS will continue to analyze tax information and data from compliance research studies to better define and quantify the tax gap. The IRS will use the results of these efforts to better understand and counter the methods and means of those taxpayers who fail to report or pay what they owe. The IRS is focusing on discouraging and deterring non-compliance with the emphasis on corrosive activity by corporations, high-income individual taxpayers, and other contributors to the tax gap.

Fraudulent Tax Refund Claims: The number of fraudulent tax refund claims continues to escalate. On-line filing and refundable credits, like the Advanced Child Care Credit and the Earned Income Tax Credit (EITC), have contributed to the increase. On-line filing makes it more difficult to identify those responsible, and self-employment income used to qualify for the EITC is difficult to verify. As of August 2005, criminal investigations increased approximately 22% over the same time period in 2004, which is the highest in the past five years. For tax return processing year 2005, fraud detection centers identified more than 33,000 questionable client returns associated with unscrupulous tax return preparers, claiming approximately \$103 million in refunds. Key to effective detection and deterrence of these fraudulent claims is the need to invest in new technology.

Abusive Tax Shelters: Abusive Tax Avoidance Transactions (ATAT) remain a challenge and a high enforcement priority for the IRS. These tax motivated transactions are corrosive to the equity and the fairness of the tax law for all taxpayers. Specifically, the prevalence and proliferation of ATAT impacts the achievement of the IRS' mission, goals, objectives, and the success of its major strategies by impeding the IRS' ability to make gains in compliance and interfering with allocation of workforce resources. Vigorous enforcement of the criminal provisions of the Internal Revenue Code, coupled with appropriate civil sanctions, materially contributes to maintaining voluntary compliance and public confidence in the fairness of the tax system.

Recent trends indicate that the tax shelter population will continue to expand to small to mid-size corporations where the issues will be more difficult to identify and examine. Promoters of tax shelters are migrating from the large accounting firms to firms and businesses that specialize in tax shelters. These promoters (boutique promoters) are less compliant for registration and less stable in their business operations, making it more difficult to pursue them for information and for penalties.

Addressing the Complexity of the Internal Revenue Code

The December 2004 Report to Congress required by the Internal Revenue Service Restructuring and Reform Act of 1998 identifies the complexity of the Internal Revenue Code as the most serious problem facing taxpayers and the IRS alike. The Code contains well over a million words, bedeviling individual taxpayers with provisions such as the alternative minimum tax and the earned income tax credit. Business taxpayers must grapple with numerous rules that cover such topics as the depreciation of equipment; numerous and overlapping filing requirements for employment taxes; and complex factors that govern the classification of workers as either employees or independent contractors. The IRS must explain the Code in a way that taxpayers can understand.

In January 2005, President Bush established an Advisory Panel on Federal Tax Reform to devise options to reform the tax code and make it simpler, fairer, and more pro-growth to benefit all Americans. In November 2005 the Advisory Panel submitted a report to the Secretary of the Treasury containing revenue neutral policy options for reforming the Internal Revenue Code. These options are intended to:

- Simplify the tax laws to reduce the costs of compliance and to make it easier for taxpayers to plan for the future and manage their affairs;
- Share the burdens and benefits of the tax system in an appropriately fair and progressive manner while recognizing the importance of homeownership and charity in American society; and

- Promote long-run economic growth, higher wages and job creation by encouraging work effort and increased saving and investment to strengthen the competitiveness of the United States in the global marketplace.

Improving the Efficiency and Effectiveness of Tax System Administration

Taxpayer Service Challenges: Delivering cost effective, efficiently valued, and effective information and services to taxpayers, while meeting demands to reduce the complexity of the tax law, being responsive to large and diverse taxpayer segments, and providing preferred means of delivery within budget limitations are challenges for the IRS. The IRS will continue to research and evaluate information regarding taxpayer service needs, priorities, and preferences in order to improve delivery services that support taxpayer preferable approaches for obtaining information or services. The IRS will seek opportunities to invest in technology, process improvement, and training to achieve consistent repeatable quality service with reduced unit delivery costs.

Technology Modernization Projects: FY 2004 and FY 2005 marked a reverse in the trend of cost overruns in the modernization program that plagued the IRS in previous years. In FY 2005, Business Systems Modernization (BSM) continues to build and improve upon its 2004 success by delivering projects, attaining cost and schedule targets, realizing benefits to taxpayers, and improving BSM program management capabilities. With the exception of the Integrated Financial System, BSM delivered all projects and releases planned on time (schedule), within budget (cost), and met or exceeded scope expectations (implemented functional and technical capability).

The FY 2006 BSM portfolio will focus on delivery of three major tax administration projects, along with infrastructure initiatives and continued improvement to program management operations. Program operations will continue to focus on improving program performance, improving and streamlin-

ing management process disciplines, and ensuring delivery of projects on time, on budget, and on scope by taking a greater ownership and leadership role in managing the BSM program.

Achieving 80 Percent e-Filing of Tax Returns:

Achieving the goal of having taxpayers submit 80% of all filings, information, and returns, electronically by FY 2007 continues to be a significant challenge. While the e-filing rate continues to increase, FY 2005 is the first year that more than half of all tax returns were filed electronically. The IRS is considering mandating e-filing for certain groups, by regulation or legislation, to ensure increased e-filing. Also, the Administration's proposal to extend the April filing date for electronically-filed tax returns to April 30, if enacted, may also increase electronic filing. But without a legislative change to mandate electronic filing, the challenge remains one of identifying options to encourage more of the taxpaying public to e-file.

**Improving Government- wide
Financial Reporting**

Treasury continues its effort in the Government-wide Accounting (GWA) Modernization Project to improve the reliability, timeliness, and exchange of financial information between the Financial Management Service (FMS), Federal Program Agencies (FPAs), the Office of Management and

Budget, and the banking community. FMS will continue its work with the FPAs to adopt uniform accounting and reporting standards and systems. FMS will develop a government-wide infrastructure to standardize definitions of federal accounting terms and their usage, and provide to agencies an interactive U.S. Standard General Ledger website and database.

The FMS implemented a new process, the closing package process, for the FY 2004 reporting cycle via its Government-wide Financial Report System (GFRS). The closing package process enabled FMS to collect agency audited Financial Statement data through GFRS to compile the FY 2004 Financial Report (FR) of the U.S. Government. Agencies utilized the GFRS to reclassify their financial statement line items to the corresponding line items required for the Financial Report. This process will continue to be used in FY 2005 and directly links agency financial statements to the Financial Report which has been a long standing material deficiency. FMS will continue to work cooperatively with the Government Accountability Office, the Office of Management and Budget, and program agencies to eliminate the issues that prevent receiving an unqualified opinion on the Financial Report of the United States Government.